to regulate; the result is still a defiance of state law. In addition, the administrative obligations that FCC would have to undertake could be overwhelming.

If a franchising authority has waived its right to regulate rates in a franchise agreement with a cable operator this should preclude the franchising authority from certifying under the Act. Section 623(j) of the Act provides that none of the rate regulation provisions of Section 623 or FCC regulations promulgated thereunder are to read as impairing rate regulation contracts that were entered into before July 1, 1990. Therefore, franchise agreements that were entered into before that date which provide that there will be no rate regulation by the franchising authority should be respected. Since clauses agreeing not to regulate rates are not preempted by the 1992 Cable Act, a franchising authority which has so agreed has no legal right to regulate basic service rates. In those cases, the FCC should disapprove a grant for certification on the ground that the franchising authority lacks the legal authority to adopt regulations.[25]

Sporadic or inconsistent regulatory enforcement of rate regulation should result in revocation of the franchising authority's certification. Certified franchising authorities have an obligation to regulate in accordance with the 1992 Cable

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[25]<u>See</u> 47 U.S.C. §543(a)(4)(B).

Act and FCC regulations.[26] One of the goals of FCC rate regulations is to reduce administrative burdens on cable operators and to ensure that basic rates are reasonable.[27] However, these two goals are frustrated when a franchising authority exercises rate regulation power in an unreasonable manner. The FCC should establish guidelines to revoke certification if the exercise of rate regulation is unreasonable. These guidelines should include provisions that require the franchising authority to provide notice and an opportunity for a hearing where the franchising authority has failed to impose regulations on a timely and reasonable basis.

4. Procedures for certification.

Falcon concurs with the concept suggested in ¶17 of the NPRM that a franchising authority should be required to demonstrate the absence of effective competition in their certification request to the FCC. Cable operators should be provided an opportunity to challenge a certification prior to its taking effect. After receipt of any response by the franchising authority, if a certification request has been opposed, the FCC should act upon the request immediately so as to avoid any negative ramifications from allowing imposition of rate

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[26]The 1992 Cable Act states that a cable operator or other party may petition the FCC for appropriate relief if the franchising authority acts in a manner inconsistent with FCC regulations. 47 U.S.C. §543(a)(5); 47 U.S.C. §543(a)(3)(A). The FCC may revoke certification if such regulations are not in conformance with FCC rules promulgated under §623(b) of the Act. 47 U.S.C. §543(a)(5).

[27]47 U.S.C. §543(b)(1) & (2)(A).

regulation in circumstances where it is not warranted. Falcon strongly believes that multichannel video programming distributors who compete with cable systems should be required to disclose the number of their subscribers and any other data relevant to the effective competition determination. This is the only way that the second statutory test for effective competition can be implemented.

Falcon strongly disagrees with the notion contained in ¶23 of the NPRM that cable operators should not be provided due process prior to the FCC's decision on a franchising authority certification application. The FCC must distinguish between three separate actions that might be taken with respect to such an application. First, there could be a denial for failure to properly certify in accordance with Section 623(a)(3). Second, there could be a revocation because the franchising authority has failed to implement and carry out its regulations in accordance with FCC standards. And three, there could be rescission of certification in the event that the FCC determines that a system has subsequently become subject to effective competition or where the Commission determines that the franchising authority lacked the legal authority to regulate rates in the first instance. The second and third situations obviously would allow for pleading cycles and other due process. In this regard, Falcon urges the FCC to establish an expedited procedure so that rate regulation by an unauthorized franchising authority will cease as soon as possible. Likewise, the initial application should be opposable because, for example, the franchising authority may have no legal power to regulate or there may be effective competition. To not give the cable operator a chance to raise these points at the outset is unfair to the operator and, in the end, burdensome on the FCC.

The effective competition test should be applied on a franchise area basis. Falcon notes however that if the geographic uniformity test for rates is applied on a system-wide basis there must be an exception for a franchise area that meets the effective competition test. Finally, whether the test applied is system-wide or limited to a franchise area it should be the same for basic rate regulation and for the regulation of cable services other than basic.

In ¶19 the FCC suggests adopting a standardized form for franchising authorities to use to request certification for rate regulation purposes. Falcon agrees with this suggestion. With regard to question 4(a) on the proposed form, however, we strongly urge the Commission to require franchising authorities to recite the specific statutory and franchise provisions which provide them with the legal authority to adopt a rate regulation scheme.

C. Regulations Governing Basic Service Tier Rates.

Under the 1992 Cable Act, the Commission must ensure that basic cable rates are "reasonable,"[28] based on the following factors: (i) rates charged by systems that are subject to effective competition; (ii) direct costs of delivering basic

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[28] 47 U.S.C. §543(b)(1).

service; (iii) the appropriate allocation of joint and common costs found to be "reasonably and properly allocable to basic"; (iv) advertising and any other revenue derived from basic; (v) franchise fees and taxes; (vi) PEG access support costs; (vii) reasonable profit; and (viii) the costs of retransmission consents.[29]

In order to ensure that basic cable rates are reasonable, the Commission has proposed adopting either: (i) a benchmark rate or rate formula; or (ii) a cost-based approach, under which an individual system's costs would be examined following traditional cost of service principles and its rates then set to permit an appropriate rate of return.[30] In deciding among these approaches, the Commission must keep in mind the 1992 Cable Act's requirement that regulations governing basic rates must reduce administrative burdens on subscribers, cable operators, franchising authorities, and the Commission.[31] This requirement can be best achieved by (1) making basic rate standards virtually self-effectuating; (2) adopting a simple formula whereby reasonable rates can be calculated with certainty based upon empirical factors without reference to system cost figures or other specific financial data; and (3) allowing cable operators subject to basic rate regulation to implement basic rate increases, subject to challenge by the franchising authority.

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[29] Id. at §543(b)(2)(C).

[30] NPRM at ¶33.

[31] 47 U.S.C. §543(b)(2)(A).

1. Rate of return regulation should not be the preferred methodology.

Under rate of return regulation, a public utility is permitted "a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[32] The Commission has previously found flaws in this approach.[33]

Congress has also reached the same conclusion, stating in the 1992 Cable Act's legislative history that "[t]he Committee is concerned that several of the terms used in this section are similar to those used in the regulation of telephone common carriers. It is not the Committee's intention to replicate Title II regulation."[34] Congress also rejected this type of regulation in Section 621(c) of the 1984 Cable Act, which is left intact by the 1992 Cable Act: "[a]ny cable system shall not be subject to

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[32]Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission, 262 U.S. 679 at 692 (1923). See also Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944).

[33]See Notice of Proposed Rulemaking, CC Docket No. 87-313 2 FCC Rcd 5208 (1987) at ¶39; Notice of Inquiry, MM Docket No. 89-600, 5 FCC Rcd 362 (1989) at ¶45; Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 3 FCC Rcd 3195, 3217-28 (1988) ("we believe that no adjustments can adequately address the inherent flaws of the rate of return approach"); Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873, 66 RR 2d 372, 382, 390 (1989) ("the flaws we have cited with regard to rate of return appear to us to be no less endemic today than when we initially examined rate of return in the course of this proceeding").

[34]House Report at 83.

regulation as a common carrier or utility by reason of providing any cable service."[35] Accordingly, we agree with the Commission's preliminary conclusion that cost-based rate of return regulation is flawed and should be therefore not be the prime rate regulation methodology.[36]

However, Falcon does concur with the Commission's tentative conclusion that the cost of service approach to basic rate regulation should be available as an alternative to be utilized as a "safety net" "for cable operators seeking to justify the reasonableness of rates that do not meet our primary benchmarking standard."[37] As the Commission recognizes, there may be instances where a cable operator cannot meet the benchmark rate because certain costs not included in the benchmark are especially high for that operator. In such circumstances the cable operator should be able to demonstrate such costs to the franchising authority or the Commission in order to obtain relief from the benchmark. Unless the cable operator could utilize this "safety net," it would face confiscatory rates, a result that neither the Congress nor the Commission intended. Falcon believes, however, that it has a better alternative method for such circumstances, a cash flow approach, which is explained infra.

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[35]47 U.S.C. §541(c) (1984).

[36]NPRM at ¶¶33, 39, 40, 57-59.

[37]NPRM at ¶33.

2. A benchmark approach is the most effective method.

Falcon agrees with the Commission's tentative conclusion to adopt a benchmark approach to basic rate regulation because "each of these benchmarking alternatives could achieve reasonable rates at lower costs and with less administrative burdens than could traditional cost-of-service regulation."[38] Specifically, we believe that benchmarks should be calculated on a per-channel basis, both for administrative ease and to account for differences in sizes of basic offerings.

The concept of a per-channel benchmark is correctly based on the idea that one overall basic service rate could not possibly reflect the various costs different cable operators face, or the differing value of each basic offering which depends largely on the number of services offered. Thus, a "low" or "reasonable" basic rate, as intended by Congress,[39] is not an absolute number, but rather a relative term based on such cost and value components. A per-channel benchmark comprised of the appropriate factors would reflect both of these components while furthering Congress' goal of providing incentives for cable operators to add services to basic beyond the statutory minimum.

However, the per-channel benchmark should not be combined with any overall cap on the basic service rate. Otherwise, the per-channel rate would become meaningless for cable operators of systems with numerous must carry or PEG access stations. For

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[38] Id.

[39] Conference Report at 62-63.

example, if the per-channel benchmark is set as $1.00, but the overall basic rate is capped at $13.00, systems with over 13 channels required on the basic tier would not be able to charge the per-channel benchmark rate.

As a refinement to the per-channel approach, certain objective cost elements could be allowed to be added to the per-channel benchmark rate. Falcon suggests that the cost of carrying non-satellite delivered distant broadcast stations, which do not have to be carried at all, is a prime candidate for an add-on. The particular costs would be the charge for microwave importation and the retransmission consent fees for these stations. This is particularly important for systems located in rural areas far from any television market. Their cost of obtaining broadcast signals far exceed that of typical urban systems.

Rather than applying a detailed cost of service analysis, a benchmark approach would identify certain empirical criteria so that cable systems could be separated into distinct classes, thus providing more reliable comparisons among similarly situated systems. The NPRM seeks "comment on what variables should be used for defining the classes of systems to which a different benchmark rate should apply."[40] We comment on the following factors, many of which were mentioned in the NPRM,[41] as

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[40]NPRM at ¶37.

[41]<u>Id</u>.

characteristics that could be used to group together similar cable systems for purposes of establishing fair benchmarks:

(a) Channel capacity. We believe that 36 channels would be an appropriate dividing line between higher and lower capacity systems. This would be consistent with the 1992 Cable Act's leased access and noncommercial must-carry sections.[42]

(b) Density. Generally, the lower the density (number of homes per route mile), the more expensive to build and operate the system, because of the extra labor, equipment, wiring, etc. required to connect a given number of homes. Falcon suggests that systems with a density of less than 60 homes per mile be considered low density systems.

(c) Age of plant. Although systems with older plant may have lower capital costs today, this factor should not play a role since such systems could be rebuilt at any time, thus dramatically increasing capital costs.

(d) Percent of aerial v. underground cable. Underground cable systems are generally more expensive to build, operate, and maintain. Accordingly, we believe that a cable system with 20 percent or more underground cable should be categorized as "heavily" underground.

(e) System size (i.e., number of subscribers served). Depending, of course, on other costs of doing business, smaller systems have fewer subscribers over which to spread their costs, so that each individual subscriber's rate could be higher

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[42] See 47 U.S.C. §§532(b)(1)(D) and 535(b)(3).

than for otherwise similarly situated larger systems. Accordingly, we believe that a 10,000 subscriber cutoff would equitably separate larger cable systems from smaller ones.

(f) MSO size. This factor could account for large variances in cable system costs, including programming acquisition, equipment, capital, etc. In this regard, the top 5 MSOs should comprise the first category due to their size, followed by MSOs 6 through 50, then MSOs below 50.

(g) Off-air broadcast signal availability. As explained above, this factor (along with PEG access) largely determines the minimum number of basic channels that must be provided.

(h) Regional cost of labor index. As the NPRM recognizes, this is "another important adjustment factor" that represents "a general change in the cost of doing business."[43]

One factor that should not even be considered is advertising revenue earned from the provision of basic service. If such revenue is given a dollar-for-dollar offset against permissible rates, cable operators will be discouraged from including more cable programming networks on the basic level, contrary to Congressional intent.[44]

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[43]NPRM at ¶38.

[44]See House Report at 82.

3. Benchmark alternatives.

In examining the benchmark concept, the Commission seeks comment on a number of alternative methods of setting a benchmark.[45]

(a) Effective competition. Examining rates charged by systems subject to effective competition would not provide a valid benchmark.[46] First, the sample size would be too small. Indeed, there are probably less than 25 active overbuilds in the U.S. today. This small number is no accident -- as numerous studies have demonstrated, most overbuilds are characterized by short term disequilibrium rates, cross-subsidizing, and below-cost pricing. Neither cable operator makes a profit, and one of the systems ultimately goes out of business or sells out to its competitor, or both systems sell out to a third party. Furthermore, although systems that face effective competition due to low penetration may be greater in number, such penetration is usually related more to demographics than to competition.[47]

(b) Past regulated rates. The Commission has tentatively chosen 1986 as the point for examining past regulated

[45]NPRM at ¶¶41-52.

[46]Id. at ¶¶41-43.

[47]See FCC 1985 Staff Study, Alternative Criteria for Defining Effective Competition: A Statistical Analysis of Small Cable Markets, at 3 (finding no direct correlation between high penetration levels and the presence or absence of effective competition); FCC Mass Media Bureau, Policy and Rules Division, Staff Report, Cable System Broadcast Signal Carriage Survey Report (Sept. 1, 1988); Report and Order in MM Docket No. 84-1296, 58 RR 2d 1, 29 (1985).

rates, without first seeking comment on this choice.[48] The Commission's only explanation for its choice is that 1986 was the last time basic cable rates were regulated.[49] However, 1986 is not an appropriate index date for one very significant reason -- the typical basic service in 1986 did not resemble the "low priced" basic level envisioned by the 1992 Cable Act. Specifically, from 1976, when satellite programming services first became available, until 1986, typical basic cable service grew to a "collapsed" basic level containing both broadcast and cable networks. Thus, examining 1986 basic rates would yield skewed results because there would be no way to separate the 1986 components of basic that are envisioned today (i.e., broadcast plus PEG access) from the satellite programming network components which charge fees to cable operators and are otherwise more expensive to carry.

Moreover, as the NPRM points out, 1986 rates reflected the effects of the urban market "bidding wars" for cable franchises, many of which resulted in artificially low rates which proved not to be economically sound. Finally, 1986 historical rates would lead to anomalous results because the sample would include both regulated and unregulated rates. Regulated rates were artificially low at that time, having lagged well behind the Consumer Price Index for the prior two decades.[50] On the other

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[48]NPRM at ¶44.

[49]Id.

[50]Bureau of Labor Statistics, Consumer Price Index, U.S. City Average, 1972 through 1986.

hand, local rate regulation was optional in 1986, and literally hundreds of franchising authorities had concluded that the costs and disadvantages of cable rate regulation outweighed the benefits.

A more accurate index date for past regulated rates would be December 31, 1975, when the only satellite programming service was Home Box Office, a per channel service, and there were no cable networks to skew rates. On this date, therefore, basic service closely resembled the basic level mandated by the 1992 Cable Act.[51] Once determined, the rate could be adjusted upward for inflation, construction and rebuild costs (both of which were contemplated by the NPRM),[52] costs of compliance with the Copyright Act of 1976, which was enacted subsequent to December 31, 1975, and the costs associated with obtaining retransmission consent.

(c) Current average rates. This benchmark would be perhaps the fairest and easiest to administer. As contemplated by the Commission, cable system per-channel rates would be compared against an average and "would be considered reasonable if they did not exceed that average by more than some fixed amount."[53] However, not all basic rates were unreasonable when the 1992 Cable Act was passed. Accordingly, the

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[51] See 47 U.S.C. §543(b)(7)(A).

[52] NPRM at ¶¶44-45.

[53] Id. at ¶46.

"reasonable" line should be drawn at some point above the current average.

(d) Cost of service. This benchmark would be unworkable for the same reasons why it is inferior to benchmarking as a method of rate regulation.

(e) Price caps. This benchmark would "define reasonable increases in rates for the basic tier."[54] We believe this is not an effective benchmark for several reasons. If a cable operator has been a "good actor" by keeping rates at or below the benchmark ultimately adopted by the Commission, there is no reason to believe it will suddenly impose excessive rate increases. Price caps would handicap operators with the lowest rates by limiting their ability to raise rates to the benchmark, which, by definition, is a reasonable price that such operators should be permitted to charge.

4. Adjustments to the benchmark.

As the Commission recognizes, the benchmark would need to be adjusted over time to account, for instance, for "appropriate empirical or market considerations."[55] Accordingly, we believe that the benchmark should be adjusted annually to account for cost changes. The Consumer Price Index ("CPI") is one logical candidate for such adjustment. However, it covers the economy as a whole and thus may not be the most accurate indicator. Two other indices might be more accurate, the local Service Price

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[54] Id. at ¶49.

[55] Id. at ¶34.

Index, if available, or the admissions component of the CPI, which measures the price of some of cable's chief competitors, including movies, theater, sports events, and concerts.

In sum, an adjusted cost per channel benchmark for basic cable service, based on the average basic rate on December 31, 1975 and annually adjusted for inflation and other market factors, would most successfully achieve Congress' goals of a "low priced" basic service level and an easily administrable formula to ensure that the rates for such service remain reasonable.

5. <u>A suggested intermediate rate regulation methodology</u>.

Falcon suggests that an intermediate step between use of a benchmark and full cost of service justification would be desirable to deal with situations where a cable operator's rate, present or proposed, is higher than the benchmark but the system is not generating a profit. Rather than bearing the burden which would fall on the cable operator and the franchising authority of going through a full-fledged cost of service study, Falcon urges the Commission to adopt a much simpler approach which measures "net income" and "free cash flow".

Free cash flow is cash flow from operations after deductions for debt service and capital expenditures. It is a readily understood concept which is used by lending institutions to evaluate the operations of borrower cable systems. Moreover, it is easy to calculate and does not require the use of a uniform set of accounts. Falcon proposes that if a cable operator is not generating sufficient free cash flow under this test, then its rates for service, even if outside the benchmark, should not be deemed unreasonable.

The test would work as follows. First, net income would be calculated on a system basis.[56] This is a recognized calculation done using generally accepted accounting principles. If this figure is negative, at that point the rate in question should be deemed "reasonable." If this figure is positive, certain expense items would be added to net income in order to reach cash flow from operations, another recognized calculation. The items to be added are depreciation, amortization, any other non-cash items, and interest expense. Then, in order to reach free cash flow, debt service (interest and repayment) and capital expenditures are subtracted. The time period comparison for the test would be a showing of free cash flow for the prior year as against projected debt service and capital expenditures for the year ahead.

Only a few adjustments would be needed to this test in any given case. For example, in the case of partnerships, which do not themselves pay income taxes, there would have to be a *pro forma* effect for taxes factored in so as to reach a comparable net income figure. Furthermore, although the showing would normally be made on a system-wide basis, there may be situations where a showing on a regional or even a company-wide basis might

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[56]A community by community breakdown, unless the community happens to be coterminous with the system, is exceedingly difficult to do without extensive allocation decisions since most companies do not keep their records on that basis.

be more appropriate. Allocation of expenses which apply to a region or to a company would have to be made where the showing applied to a single system.[57] Also, the requested rate would have to be justified as a percentage of overall revenues since the free cash flow showing would be for a cable system's entire operation, not just the basic service. Thus, for example, if basic service revenue constituted 10 percent of a system's revenue last year, and the free cash flow test is not passed by the system, a rate increase would be justified up to the point where basic revenue equalled 10 percent of total projected revenue for the coming year. Finally, for those companies which engage in activities which are not cable system related, such as broadcast stations or programming services, Falcon strongly believes that all non-cable financial information must be divorced from any free cash flow analysis.[58] The mixing of revenues and expenses from disparate activities not only runs the risk of cross-subsidization, but also prevents the development of clear and consistent comparisons.

The reason why free cash flow is so important, and thus a proper measurement for this purpose, is that it is a common covenanted figure in credit agreements. Thus, a borrower cable operator might have to maintain a free cash flow ratio of, say, 125 percent, i.e., for each dollar of debt service and capital

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[57]The propriety of allocation decisions could be substantiated by certifications from a company's auditors.

[58]Again, auditors' assurances that the proper separation had been done could be required.

expenditure requirements for the year there must be operating cash flow of $1.25. Indeed, because loan covenants always require this type of margin, Falcon submits that the free cash flow test should not be deemed passed unless free cash flow exceeds the total of debt service and capital expenditures by 25 percent.

Absent a test of this sort, a cable system with basic rates outside the benchmark level would have to go through a burdensome cost of service showing. The risk of not passing such a test is that a cable operator may not be allowed a rate increase or even may be required to roll back its rates to the benchmark level. In many such cases, if the loss in revenue could not be recovered from other services and charges, the financial ratios required in the credit agreements with the system's lenders could be violated. Loans could then be called and the cable operator might have to sell its system. Falcon is certain that Congress did not intend such a draconian result when it enacted the rate regulation provisions. A fallback test such as the one suggested here is an excellent way to protect cable operator and subscriber alike without undue complication.

D. Regulation of Rates for Equipment

The 1992 Cable Act establishes two distinct approaches for evaluating the rates charged by cable operators for various types of equipment provided to cable subscribers. Specifically, pursuant to Section 623(b)(3), the Commission's basic rate regulations are to include rate standards for "installation and lease of the equipment used by subscribers to receive the basic service tier," as well as "installation and monthly use of connections for additional television receivers" ("additional outlets" or "AOs.") Pursuant to Section 623(c), on the other hand, the Commission's regulations applicable to cable programming services (or "tiers") are to include "installation or rental of equipment used for the receipt of such video programming." Equipment utilized solely to receive pay or a la carte services would remain outside either standard and would continue to be deregulated.

1. Only Equipment Used Solely to Receive Basic Service is Regulated Based on Actual Cost.

As the NPRM correctly points out,[59] the 1992 Cable Act clearly distinguishes between regulation of rates for equipment used to receive basic service and equipment used to receive cable programming services. One key difference is that regulation of equipment used to receive basic service involves pricing based on actual cost. This criterion will ensure that the rates for basic equipment are reasonable. Oversight of rates for equipment associated with cable programming service involves cost as only one of several factors to be considered. Unlike basic equipment regulation, the issue under Section 623(c) is whether the non-basic equipment rates are so egregious and out of range as to be "bad actor" rates. Thus, the clear intent of the 1992 Cable Act is to provide two different approaches to rate scrutiny.

This intent to have different standards for basic, non-basic, and premium service-related equipment is further evidenced

[59]NPRM at ¶64.

by an examination of Section 623(b)(3)(A) of the 1992 Cable Act, which specifies the two types of equipment that must be priced as basic equipment (i.e., based on actual cost): (1) equipment "used by subscribers to receive the basic service tier," and (2) "such addressable converter box or other equipment as is required" for a basic-only subscriber to receive programming on a per channel or per program basis pursuant to Section 623(b)(8) of the 1992 Cable Act (i.e., without being required to "buy through" intermediate service tiers).[60] If Congress intended all equipment to be priced at actual cost, there would have been no need to specify that rates applicable to descrambling equipment used to receive pay services by a basic-only subscriber should be reviewed on the basis of actual cost, because such equipment would have been included. Rather, Congress must have intended that equipment used to receive premium service as well as basic service need not be evaluated on the basis of actual cost, except in the limited situation of a basic subscriber receiving pay services without intervening non-basic tiers and taking advantage of the 1992 Cable Act's anti buy-through provisions. There is simply no other logical way to read the foregoing provisions of the 1992 Cable Act.[61]

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[60]47 U.S.C. §543(b)(3)(A) (emphasis added).

[61]Moreover, a cable operator who charges a different price to non-basic or pay subscribers for converter box equipment does not violate the 1992 Cable Act's uniform rate structure provisions, 47 U.S.C. §543(d), since all subscribers who request the same service in the same geographic area will still be charged the same rate. Subscribers who request different services, however, which require different uses of the converter box, may be charged (continued...)

Accordingly, the Commission should clarify that the capacity for cable equipment to receive non-basic and pay as well as basic programming cannot determine how it is regulated. Rather, the service level of the subscriber using particular equipment should determine its level of regulatory scrutiny. Thus, only equipment used solely to receive basic service should be subject to pricing based on actual cost. If equipment (such as a remote control) is not even offered to a basic-only subscriber, then it obviously cannot be deemed "used to receive basic service" and thus would not need to be priced based on actual cost. Rates or charges for equipment used by subscribers to receive cable programming services should be analyzed under Section 623(c), concerning unreasonable cable programming service rates. Equipment used for services that are neither basic nor cable programming services (*i.e.*, "per channel," "per program," or "pay" services), should not be subject to any rate regulation, because such services are themselves exempt from rate regulation.[62]

Similarly, if the same equipment (such as a remote control) that is offered to basic subscribers is also offered to and used by subscribers to receive higher levels of service, the equipment rate charged to the non-basic subscribers should be subject to

[61](...continued) different rates. In addition, this practice would not violate the non-discrimination clause of the 1992 Cable Act's anti buy-through prohibition, since there would be no discrimination as to "rates charged for video programming." 47 U.S.C. §543(b)(8)(A).

[62]*See* 47 U.S.C. §543(1)(2) (definition of "cable programming service" excludes "video programming carried on a per channel or per program basis").

non-basic rate standards contained in Section 623(c), or no regulation at all, depending on whether cable programming services or pay services were being subscribed to. For example, if the subscriber needs an addressable box to descramble tier service, the Section 623(c) rate regulation standard for cable programming services would apply. If, however, the subscriber uses the addressable box only to receive a pay programming tier, the device would not be subject to any rate regulation. Unless this distinction is maintained as to equipment common to different levels of service, Congressional intent would be thwarted.[63]

A simple analogy is illustrative here. When a subscriber selects an expanded service package from the cable operator, the subscriber will also receive the basic service level. This fact, however, does not require the entire service package to be regulated under the basic rate formula -- only the basic level is subject to basic rate regulation.[64] Likewise, the fact that equipment provided to subscribers to receive cable programming service or pay services also contains the capability of delivering basic service does not mean that the equipment is subject to the actual cost test applied to basic service

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[63]In requiring that basic rates be "low," Congress has apparently anticipated that revenues from equipment used to receive non-basic or pay services might be used to subsidize rates for equipment used to receive basic service. See Conference Report at 63.

[64]See 47 U.S.C. §543(b)(1). In fact, the Commission concludes in the NPRM that the 1992 Cable Act's definition of "basic service" contemplates only a single tier. NPRM at ¶13.

equipment. Cable operators and other equipment marketers should remain free to offer equipment that, for reasons of technical superiority, consumer friendliness, or otherwise, combines the capacity to receive different types of programming, without the specter of "actual cost" regulation.

In sum, the equipment price charged to basic-only subscribers can and should be distinguished from the equipment price charged to non-basic or pay subscribers who receive cable programming or pay programming services in addition to basic service, even where the same equipment can perform all three functions.

2. Equipment Rates Should be Deregulated if Competition from Independent Suppliers Exists.

The 1992 Cable Act's definition of "effective competition" applies to the service rendered by cable television, not equipment, installation, and AOs.[65] However, this does not mean that the Commission cannot adopt such a test. The FCC is required to minimize the burdens on the agency, cable operators, franchising authorities, and subscribers in developing a basic rate regulation framework.[66] Establishing a standard by which rates for basic equipment can be totally deregulated is wholly consistent with this requirement. Additionally, deregulation of rates for equipment, installations, and AOs in such instances

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[65] 47 U.S.C. §543(1)(1).

[66] *Id*. at §543(b)(2)(A).

would further the policy of the 1992 Cable Act to "rely on the marketplace, to the maximum extent feasible."[67]

In establishing an "effective competition test" for equipment, the Commission should keep in mind the statute's requirement that the Commission "promote the commercial availability, from cable operators and retail vendors that are not affiliated with cable systems, of converter boxes and of remote control devices compatible with converter boxes."[68] Thus, the test adopted by the Commission should be consistent with the goals of Section 17. Specifically, if the cable operator certifies that a particular piece of equipment is available for sale or lease from third party sources, and has so advised its subscribers, the price for that equipment should be deregulated.[69] Not only would such a test be wholly consistent with Congressional intent as explained above, it would also be fully consistent with the certification procedures in the 1992 Cable Act's basic rate regulation provisions.[70]

3. Rate Setting Issues.

The 1992 Cable Act and the questions raised in the NPRM lead to various rate setting issues regarding equipment, including the meaning of "on the basis of actual cost," the ability of cable

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[67]Id. at §§2(b)(1), (2).

[68]Id. at §544A(b)(2)(C).

[69]Obviously, a cable operator making such a certification regarding remote control equipment would be precluded from taking actions to disable commercially available remote control units.

[70]See 47 U.S.C. §§543(a)(2) - (4).